No. 10,220

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

District Court No. 20,473-S

MOUNT TIVY WINERY, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California District, and UNITED STATES OF AMERICA, *Appellees.*

District Court No. 20,464-R

CALIFORNIA WINERIES AND DISTILLERIES, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California District, and UNITED STATES OF AMERICA, *Appellees.*

District Court No. 20,465-L

FRESNO WINERY, INC. (a corporation), etc., *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 20,466-R

SANTA LUCIA WINERIES, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 20,467-S

CHARLES DUBBS and SAMUEL CAPLAN, Co-partners doing business as ALTA WINERY AND DISTILLERY, *Appellants,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 20,474-W

CALIFORNIA GROWERS WINERIES, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 21,113-L

ST. GEORGE WINERY (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

APPELLANTS' REPLY BRIEF.

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Subject Index

ISSUES CLARIFIED.

Since filing the opening brief several matters have been clarified by admissions in the government's reply brief.

As pointed out in *Deputy v. Du Pont,* 308 U. S. 488, 499, the facts and the law involved in these cases is open for determination here, unfettered by findings and rulings below.

FACTS AGREED UPON.

Inasmuch as the facts were agreed upon in written stipulations (R. 14-36), there should be no question as to these facts. However, appellants disagree with certain inferences and conclusions drawn therefrom by appellees in their Brief filed herein, which will be discussed later.

LEGAL ISSUES DISPUTED.

The major controversy arises in the application of the law to the agreed statement of facts. In this regard the legal issues involved are disputed, as are certain inferences and conclusions drawn by appellees from the facts agreed upon.

ISSUES.

Appellants contend (See Appellants' Opening Brief, pages 27-54, hereinafter referred to as AOB), that the wine, upon which the tax was assessed and col-

lected, was not "held" by them on January 12, 1934, within the meaning of Section 10(c) of the Liquor Taxing Act of 1934, c. 1, 48 Stat. 313, 26 U.S.C.A. §451(b), 1934 Cumulative Annual Pocket Part, which contention is denied by Appellees (Brief for Appellees, pages 15-26, hereinafter referred to as BA).

Further, Appellants contend that even if it be found that such wine was so "held" by them on the taxable date, that nonetheless they were not liable for the tax assessed and collected because the tax imposed, under Section 10(c) of the Liquor Taxing Act of 1934, was a direct, rather than an excise, tax and was in violation of the provisions of the United States Constitution set forth in AOB, pages 55-56. Again, Appellees oppose this contention and conclude (BA 27-31) that the tax imposed was and is a valid excise tax and hence does not violate any provision of the Constitution.

With the major legal issues joined, a re-examination of the facts (R. 14-36) is necessary. (See AOB 7-18 and BA 3-14).

DISAGREEMENT AS TO INFERENCES AND CONCLUSIONS.

Appellants and Appellees are in disagreement as to the correct inferences and conclusions to be drawn from the statement of facts agreed upon.

On pages 5-6 BA, Appellees infer that the only way that the wine, covered by the warehouse receipts, could be disposed of is *upon foreclosure,* whereas the

fact is (R. 34, Exhibit "A") that the wine could be disposed of *"upon foreclosure or otherwise"*.

Likewise, Appellees infer (BA 6) that the wine, covered by the warehouse receipts, could only be transferred to a permit holder because (R. 34, Exhibit "A" 1(1)) the power or authority to possess or use the wine could only be disposed of to a bona fide holder of a permit entitling the permittee to acquire or otherwise deal with the said wine. While the warehouse receipts themselves could only be transferred to a permit holder, so far as the power or authority to possess or use the wine covered thereby, nowhere is the attention of this Court directed to any prohibition against the transfer of the warehouse receipts and the title to the wine to one other than a permit holder. Of course, if such a transfer of title occurred the new owner merely could not possess or use the wine, unless a permit holder.

TRANSFER OF WAREHOUSE RECEIPTS NOT INVOLVED.

Appellees overlook, apparently, that the issue as to the transferability of the warehouse receipts to the Bank is not involved here because the Warehouse Receipts, negotiable in form, were not transferred to the Bank, rather they were issued by the warehouse in the name of and delivered to the Bank by the warehouse as the owner of the wine described therein. Even the fact that these Receipts were issued in the name of the Bank is omitted in Appellees' Statement of Facts (BA 9). It is important to remember that

these Warehouse Receipts were never issued in the name of or to the order of Appellants, nor were they delivered to Appellants by the Warehouse or the Bank. Consequently, these Warehouse Receipts could not have been delivered by Appellants to the Bank as *security* or as a *"pledge"* under the Collateral Agreement executed between Appellants and the Bank (R. 34, Exhibit "M-1"). Therefore, the statement by Appellees (BA 14-15), "The evidence shows that the receipts were delivered to the Bank *pursuant* to an agreement which gave the terms of loans made by the Bank to the taxpayer and *indicated* that such receipts were being transferred as a *pledge,* not as a result of a sale to the Bank. Thus, the Bank held the receipts merely as *security* for these loans and could claim the wine *only in case of default,* but as there was no default, it never had a right to take the wine from the warehouse." is an unwarranted conclusion from the agreed and actual facts. As pointed out later, the Stipulation of Facts, except as to the assessment and collection of taxes imposed, related solely to the period up to and including *January 12, 1934.* In fact defaults did occur thereafter, contrary to the statement of Appellees.

ACTS, RATHER THAN INTENT, CONTROL.

In other words, it is necessary for this Court to ascertain what was done by Appellants, the Warehouse and the Bank, rather than what these parties might have intended to do. Actions, rather than words, should be determinative of the legal issues presented.

It is admitted that Appellants and the Bank executed the Collateral Agreement which probably contemplated that collateral security of some kind would be forthcoming, in which case any property so received as collateral security would be subject to the terms and conditions of the agreement.

RECEIPTS ISSUED PRIOR TO EXECUTION OF COLLATERAL AGREEMENT.

However, it should not be forgotten that most of the Warehouse Receipts involved were issued to the order of and were delivered by the Warehouse to the Bank <u>prior</u> to the execution of the Collateral Agreement, as were promissory notes evidencing advances of money to Appellants by the Bank for credit purposes to enable Appellants to produce, process and manufacture the wine (R. 20-21).

ONLY PROPERTY OWNED ASSIGNED.

Further, as pointed out in paragraph two of the Collateral Agreement, contrary to the inference of Appellees (BA 10), not *all* property delivered to the Bank "then or later" would be assigned to, or deposited with the Bank. Rather, the agreement states that only that property of which the Appellants are the owners would be so assigned or deposited.

Under paragraph four of this agreement (R. 34, Exhibit "M-1") the Bank was authorized to transfer

any warehouse receipts or other collateral security to its own or to the name of any other person, as pledgee, trustee, or otherwise. Therefore, had the Bank received the Warehouse Receipts in question as collateral security under the collateral agreement, and had thereafter caused the same to be transferred to its own name, it would have become the owner thereof by such action, unless it had designated that it held the security in its name as pledgee or trustee, and not *otherwise,* in view of the provisions of the California Uniform Warehouse Receipts Act. (AOB 41-42).

RECEIPTS ENDORSED AND NEGOTIATED.

The statement by Appellees (BA 11), "None of the receipts were ever endorsed or negotiated by it" is untrue as shown in the Stipulation of Facts (R. 26-27). Further, with the exceptions therein noted, the Stipulation of Facts concerning endorsement and negotiation of the receipts covers the period up to and including January 12, 1934 only, because, although not covered by the Stipulation because believed not necessary to the determination of the case, certain of the warehouse receipts were negotiated and endorsed by the Bank to another bank sometime after January 12, 1934.

RECEIPT AUTHORIZED FOR CREDIT PURPOSES.

Appellees seek to establish that regardless of the fact that the warehouse receipts were originally issued

in the name of and delivered to the Bank by the warehouse, that when the Bank received these warehouse receipts it did so, not as the *"owner"* and entitled to the possession of the wine represented thereby, but rather as a *"pledgee"* under the Collateral Agreement, even though the warehouse receipts were issued before the Collateral Agreement was executed. **Obviously, Appellees overlook the express provisions of Exhibit "A" (R. 34) which expressly authorized the storage of wine for "credit purposes"; also, that said regulation, known as Treasury Decision 19, merely prohibited any person, firm or corporation advancing credit upon the security of such wine or upon the security of warehouse receipts or other instruments issued on account thereof from having the power or authority to possess or use the wine in any manner or to dispose of it upon foreclosure or otherwise.** This regulation did not prohibit the transfer of title to the wine represented by the warehouse receipts to one other than a bona fide holder of a permit entitling the permittee to buy or otherwise deal with the wine; also, it did not prevent such other person from claiming the wine. As the warehouse receipts were issued in the name and delivered to the Bank, Appellees' argument (BA 15) that the Bank could claim the wine only in case of default, is contrary to the facts and the California Uniform Warehouse Receipts Act, Ante, Section 8 (See also AOB 41-46 for other authorities).

CREDIT DEFINED.

"Credit" is defined by Webster's New International Dictionary, 1930 edition, as "to trust, loan, believe". For commercial purposes, that authority defines credit as "trust given or received; expectation of future payment for property transferred or of fulfillment of promises given; the relative circumstances between one person and another who trusts in him to pay or render a sum in the future; mercantile reputation entitling one to be trusted as, to buy goods on credit. Credit is nothing but an expectation of money, within some limited length of time. Locke. The time given for payment for lands or goods sold on trust; as, as long credit or short credit."

Further, this same authority defines *credit* for bookkeeping purposes as, "a. Acknowledgment of payment by entering in an account; b. The side of an account on which are entered all items reckoned as values received from the party or the category named in the head of the account; also, any one, or the sum of these items; the opposite of debits as, this sum is carried to one's credit, and that to his debit"; also, as "the balance in a person's favor in an account; also, an amount or limit to the extent of which a person may receive goods or money on trust; specifically an amount or sum placed at a person's disposal by a bank."

This same authority also defines *credit* as "to sell goods to on credit", and "to enter upon the credit side of an account; to give credit for; as, to credit to a man the amount paid; to place to the credit of; as, to credit a debtor with an amount paid."

From these definitions of credit it is obvious that the warehouse receipts were issued in the name of and delivered to the Bank in consideration of credit extended, for credit purposes, by the Bank prior to the execution of the Collateral Agreement. There was no prohibition in the regulations against the issuance of the warehouse receipts in the name and to the order of the Bank. It was not necessary that the warehouse receipts be issued and delivered to the Appellants or thereafter delivered by Appellants to the Bank as collateral security. Consequently, it is significant that these latter steps did not occur, as is inferred and urged by Appellees.

SALE OF WINE OCCURRED.

Therefore, as is pointed out in *Earle C. Anthony, Inc. v. United States,* 57 C. Cls. 259, the mere fact that Appellants might have been entitled, pursuant to agreement or understanding with the Bank, to have the wine returned to them upon payment of any sums due from Appellants to the Bank, such circumstances would not prevent the transfer being a sale. In other words, a mere right retained or a reservation of title does not prevent a transaction from becoming complete and, subject to the provisions, in the instant cases, of the Uniform Warehouse Receipts Act under which the Bank became the owner and entitled to the possession of the wine, subject, of course, to T. D. 19.

"TO HOLD" HAS A DIFFERENT MEANING THAN "HELD".

Obviously, Appellees fail to realize that the words "to hold" have an entirely different meaning than the word "held" used in the instant tax statute. For example, one can ask another "to hold" something for him, regardless of whether such person owned or had the title to the article in question. Also, "to hold" can refer to a condition in which there is no ownership or title, as in the case of the adverse possession of real property or the hypothecation of personal property. As set forth in AOB 29-30, the word "held" implies ownership and refers to one who has the legal right or title to a thing, whether the possessor or not.

Therefore, Appellees are not entitled to the construction of the tax statute urged (BA 16-19), that will extend, by implication or otherwise, the natural, ordinary and generally understood meaning of the term "held" used (AOB 22-27). Nor are Appellees entitled to a construction of the tax statute which will create an ambiguity or otherwise resolve a doubt in their favor rather than in favor of Appellants (AOB 33-35).

APPELLANTS PERFORMED CONTRACTUAL OBLIGATIONS.

Appellees argue at length (BA 19-22), in substance, that the actions of the Appellants in caring for the wine, payment of the personal property taxes thereon, etcetera, establishes that appellants had an interest

in the wine. They do not point out clearly that all of Appellants' actions were pursuant to and in performance of contractual obligations and supported by good consideration, which fact justifies a different inference being drawn from the statement of facts than that advanced by Appellees.

BANK IS "OWNER" RATHER THAN "PLEDGEE".

Appellees make much of the provision in the Collateral Agreement (AB 24-25) wherein the provisions of Section 3006 of the Civil Code of California are waived. Appellants contend that the provisions of the Civil Code, relating to pledges, are inapplicable to the instant cases, for reasons previously discussed; also that it is immaterial if they are applicable. Moreover, a reading of Sections 2986-3011, inclusive, of the Civil Code of California, relating to Pledges, defines the nature and character thereof and outlines the duties and obligations of a pledgee. These provisions, among other things, prohibit a sale of the property pledged until performance has been demanded and notice of sale has been personally given to the pledgor, also, specifies that the sale must be by public auction and the proceeds disposed of as therein set forth. In the instant cases, the Bank sold substantial quantities of the wine covered by the warehouse receipts from time to time, and even had new receipts, negotiable in form, issued to it, without any compliance with these provisions of the Civil Code. Certainly, this should indicate that in so far as the

warehouse receipts here are concerned, that they were taken and held by the Bank as owner, rather than under the provisions of the Collateral Agreement, because under the Collateral Agreement a full compliance with the law of pledges would have been necessary in the event the Bank was a pledgee, as contended by Appellees, of the warehouse receipts.

WAREHOUSE RECEIPTS TRANSFERRED.

In the four cases cited by Appellees (BA 23-25) to support the statement that the Bank got a qualified, not an absolute, title to the wine, it is significant that therein warehouse receipts were originally issued in the name of the transferor and were thereafter endorsed, transferred, and delivered by the transferor to the pledgee as collateral security under a pledge agreement. This situation is not present here. Moreover, in those cases, while the courts therein state that the Bank on a pledge did get a qualified title, apparently they find no qualifications on the title, other than the pledgor's right to redeem and the liability for storage charges. As is pointed out in the case of *Heffron v. Bank of America N. T. & Savings Ass'n,* 11 F. (2d) 239 (C. C. A. 9th), and in other cases cited in Appellants' Opening Brief, one to whom the title to property has been transferred is entitled to retain the wine even against the trustees of the transferor, pledgor or mortgagor or his creditors. Certainly, Appellees do not possess the same equitable rights as these parties. Therefore, it is illogical to

contend that for tax purposes a debtor owns or is entitled to the possession of property whereas such is not true in other cases even where the equities are involved.

PLUGGING THE GAP.

Appellees seek to have this Court "plug a gap" which exists in the Liquor Taxing Act of 1934, which gap is occasioned by the failure to include within the tax law express language to include the provision which Appellees now desire to have inserted therein by this Court. They are trying to correct this admitted oversight by judicial decision incorporating therein additional language and a new construction. That this cannot be done at this time is clearly indicated in the decisions set forth in the Appellants' Opening Brief (Pages 22-37, 33-35).

In *Douglass v. Wolcott Storage & Ice Co.,* 295 N. Y. S. 675, 251 App. Div. 79, plaintiff, who had endorsed and delivered negotiable warehouse receipts as collateral security for a debt, was denied the right of recovery against the warehouse for damages to the property covered by the warehouse receipts because, as the Court says (Page 678):

> "Plaintiff did not then own or have a right to dispose of a part of this fruit";

also,

> "* * * plaintiffs can hardly be heard to say that they sold or attempted to sell merchandise that they did not own or to which they could not convey a good title."

Even a guarantor of a note, to whom a warehouse receipt deposited as collateral security, had been transferred, is entitled to the property. *Driggs v. Dean,* 167 N. Y. 121, 60 N. E. 336.

Further, in *Millichamp v. First National Bank of Toppenish,* 130 Washington 175, 226 Pacific 490, the Court emphasized the fact that a pledgee, to whom a warehouse receipt issued in the name of the pledgor has been deposited with the pledgor as collateral security, did not do anything which shows that the pledgee took or assumed possession, or control over the stored property, that such pledgee, holding such warehouse receipts as collateral security, could not be held liable for storage charges. As pointed out previously, the Bank in the instant cases exercised and took control over the stored property (R. 25-26), hence, except for the contractual agreement to the contrary, would have been liable for the storage charges.

GOVERNMENT ADMITS BANK HAD TITLE TO WINE.

So far as the title is concerned, Appellees admit that the title was in the Bank by virtue of the warehouse receipts (**BA** 23) but now contends (for previous position see **AOB** 48) that this was a limited title. Exactly what is meant by a limited title is a question, but apparently the Appellees' position is, that while title passed to the Bank completely, the Appellants had the right, by paying the obligation, to demand that the title to the property be returned to them. At the date of the enactment of the taxing

statute the obligation was unpaid; therefore, at that date the title was in the Bank.

BANK HAD POSSESSION AND CONTROL OF WINE.

On the matter of possession it is clear that the Bank was in possession by virtue of the warehouse receipts. Whether the matter be classed as a pledge according to the government's contention or whether it is an outright conveyance subject to a right to demand the return of the property upon the happening of a condition subsequent, in either event the transaction requires a change of possession. By virtue of the Warehouse Receipts Act the warehouse holds possession as an agent or bailee of the person to whom the warehouse receipts were issued.

Having both title and possession, it follows that the Bank had control and authority over the wine. The Bank could do anything it wished to with the wine, except as restricted by T. D. 19, at the date of the enactment of the statute, and the obligation not at that time having been paid, Appellants could not have maintained an action for conversion but simply an action on contract.

IMMATERIAL WHETHER INTEREST OF BANK IS AS OWNER OR PLEDGEE.

The question then arises as to the interest, if any, held by Appellants. Our position is that at that time, the date upon which the tax was fixed, Appellant had no more right in and to the wine in question than a

pledgor, if as much. In the case of *Cushing v. Building Assn.*, 165 Cal. 731, 134 Pac. 324, the California Supreme Court held that the pledgor retains no right in regard to the property other than the right to receive it from the pledgee upon paying the debt for which it was held or in the event of a sale, to receive any surplus over and above the amount necessary to satisfy the debt. The only interest Appellant had in the wine at that time was an inchoate right, to demand in the future, if the obligation was paid, that the title and possession of the wine be returned to him. If Congress had meant to tax such an interest they certainly did not state such intention in the statute.

Printing restrictions prevent a further analysis and response to the brief of Appellees at this time, relating to whether Appellants held the wine on the taxable date, other than the statement of Appellees (BA 19) that the parties did the *only* thing which could be done under the circumstances, and that was to deliver to the Bank the warehouse receipts covering the wine. In this connection, as previously indicated, Appellants could have had the warehouse receipts issued to them and thereafter hypothecate them as collateral security, and even thereafter endorse and transfer the receipts to the Bank, rather than what was done, namely, issuance in the name of the Bank and delivery of the warehouse receipts to the Bank.

CONSTITUTIONAL ISSUES INVOLVED.

Appellants deny the statement of Appellees (BA 27) that the tax was applied to all wine producers in the United States on the taxable date holding wine intended for sale or used for the manufacture of wine to be sold. Referring to Section 10(c) of the Liquor Taxing Act of 1934, it will be noted that under the express language thereof the tax is only imposed "upon all wines held by the *producers thereof.*" Therefore, if a *producer* of wine held wine not *produced* by him but by another producer, no tax would be due under the express provisions of the law upon any wine so held, unless produced and held by him as a producer on the taxable date within the provisions of the tax law. Hence, the tax statute is not uniform as to all wine producers, as is required under the provisions of the Constitution of the United States cited in Appellants' Opening Brief (pages 55-56), nor does it apply to other wine otherwise held within the provisions of the tax statute by any other person than a producer thereof.

THE QUESTION OF CONSTITUTIONALITY.

We are in accordance with the statement regarding the nature of direct and indirect taxes as set forth in the Appellees' brief (page 28) observing therein the taxes held to be excise taxes in the various cases cited are upon the use or exercise of a power over property. Even in the case of *Patton v. Brady, Executrix,* 114 U. S. 608, singled out by Appellees for

special mention, the tax was not payable until the sale of the tobacco, or in other words, until the intention to sell was actually exercised and a sale made.

If a tax such as this which taxes a mere unexpressed "intent" to do something with property rather than a use, power or privilege, in connection with the property, is upheld as an indirect or excise tax, there is no limit to the extent of the Federal Government's right to tax persons because of their general ownership of property, by merely adding the requirement of an intent to do or refrain from doing something with it.

Therefore, we respectfully submit, for these and the reasons discussed in Appellants' Opening Brief, that the judgment of the Court below should be reversed.

Dated, San Francisco,
November 27, 1942.

Respectfully submitted,
Robert H. Fouke,
Attorney for Appellants.